

RECEIVED
O.E.T.C.

File No. SR-OCC-2005-23

Page 2 of 24

2005 DEC 16 PM 3: 52

OFFICE OF THE SECRETARIAT

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 19b-4

Proposed Rule Change

by

THE OPTIONS CLEARING CORPORATION

**Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934**

Item 1. Text of the proposed Rule Change

The Options Clearing Corporation (“OCC” or the “Corporation”) proposes to amend Article I, Section 1 and Article VI, Section 3 of its By-Laws and Chapter XI, Section 1104 of its Rules as set forth below for the purpose of permitting a fuller use of margin in the event of a Clearing Member default and to eliminate ambiguity by explicitly recognizing limitations on the use of customer securities that have been imposed under existing interpretations of the hypothecation rules.

Material proposed to be added to OCC’s By-Laws and Rules as currently in effect is underlined and material proposed to be deleted is enclosed in bold brackets.

THE OPTIONS CLEARING CORPORATION

BY-LAWS

ARTICLE I

Definitions

SECTION 1. Unless the context requires otherwise (or except as otherwise specified in the By-Laws), the terms defined herein shall, for all purposes of these By-Laws and the Rules of the Corporation, have the meanings herein specified.

A.—F. [no change]

G.

General Lien

(1) The term “general lien” means a security interest of the Corporation in all or specified assets in a Clearing Member account as security for all of the Clearing Member’s obligations to the Corporation regardless of the source or nature of such obligations.

General Lien Account

(2) The term “general lien account” means any account of a Clearing Member with the Corporation over which the Corporation has a general lien over all assets in the account. General lien accounts include, but are not limited to, a firm lien account, a proprietary Market-Maker’s account, proprietary combined Market-Makers’ account or proprietary futures professional account.

(1)-(5) [renumbered (3)-(7); otherwise, no change.]

H.—Q. [no change]

R. (1)-(5) [no change]

Restricted Lien

(6) The term “restricted lien” means a security interest of the Corporation in specified assets (including any proceeds thereof) in an account of a Clearing Member with the Corporation as security for the Clearing Member’s obligations to the Corporation arising from such account or, to the extent so provided in the By-Laws or Rules, a specified group of accounts that includes such account including, without limitation, obligations in respect of all Exchange transactions effected through such account or group of accounts, short positions maintained in such account or group of accounts, and exercise notices assigned to such account or group of accounts.

Restricted Lien Account

(7) The term “restricted lien account” means any account of a Clearing Member with the Corporation over which the Corporation has a restricted lien with respect to specified assets (including any proceeds thereof) in such account. Restricted lien accounts include but are not limited to, a firm non-lien account, a non-proprietary Market-Maker’s account, a non-proprietary combined Market-Makers’ account, a customer lien account, a customers’ account, a JBO Participants’ account and a segregated futures account.

(6)-(7) [renumbered (8)-(9); otherwise, no change]

S.—Z. [no change]

* * *

ARTICLE VI

Clearance of Exchange Transactions

* * *

Maintenance of Accounts

SECTION 3. Every Clearing Member may establish and maintain with the Corporation one or more of the following accounts:

(a) A firm account, which shall be confined to (i) the Exchange transactions in cleared securities other than security futures of such Clearing Member's non-customers, (ii) the Exchange transactions in (x) futures other than security futures and (y) futures options of persons whose transactions are not required to be treated as the transactions of futures customers, and (iii) the Exchange transactions in security futures of persons whose transactions are not required to be treated as the transactions either of securities customers or of futures customers. The Clearing Member, on behalf of itself and each other non-customer on whose behalf positions may be maintained in the firm account, agrees that the Corporation shall have a general lien on all positions and on all other securities, margin and other funds and property in such account [as security for all of the Clearing Member's obligations to the Corporation], the Corporation shall have the right to net all writing transactions against all purchase transactions effected in such account in accordance with the Rules, and the Corporation may close out the positions in the account and apply the proceeds thereof at any time without prior notice to the Clearing Member or any other non-customer. Such firm account shall be a "firm lien account." The Corporation may also permit each Clearing Member to establish a "firm non-lien account," which shall be confined to those Exchange transactions of non-customers of the Clearing Member in respect of which the Clearing Member does not intend to give the Corporation a lien on the segregated long positions in the account (although the Corporation shall have a restricted lien [to the extent set forth in the By-Laws and Rules] on the unsegregated long positions in securities options and on other securities (including security futures) therein and the proceeds thereof and a general lien on all other property (other than segregated long positions) in such account [on all margin deposited with the Corporation in respect of such account]). The firm non-lien account shall be subject to the same margin requirements as the Clearing Member's customers' account.

(b) A separate Market-Maker's account, which shall be confined to the Exchange transactions of the Market-Maker for which it is established. In addition, a Clearing Member who is registered with an Exchange or security futures market as a Market-Maker may maintain a separate Market-Maker's account, which shall be confined to such Clearing Member's Exchange transactions as such Market-Maker (including the Exchange transactions of a specialist unit in which such Clearing Member is a participant). The Clearing Member agrees, and represents to the Corporation that it has obtained the agreement of each Market-Maker on

whose behalf positions may be maintained in a Market-Maker's account, that (i) the Corporation shall have a restricted lien on long positions[,] in securities options and on other securities (including security futures) [, margin and other funds] in such Market-Maker's account and the proceeds thereof and a general lien on all other funds and property in such Market-Maker's account [with the Clearing Member as security for the Clearing Member's obligations to the Corporation in respect of all Exchange transactions effected through such account, short positions maintained in such account, and exercise notices assigned to such account], (ii) the Corporation shall have the right to net all writing transactions against all purchase transactions effected in such account in accordance with the Rules, and (iii) the Corporation may close out the positions in the account, and apply the proceeds thereof, at any time without prior notice to the Clearing Member or Market-Maker, and (iv) notwithstanding the provisions of clause (i) hereof, if the Market-Maker is the Clearing Member or a proprietary Market-Maker, the [Corporation's] Corporation shall have a general lien on all [long] positions and on all other securities, margin, and other funds and property in such account, [shall be security for all of the Clearing Member's obligations to the Corporation] and the account shall be a "firm lien account."

(c) A combined Market-Makers' account, which shall be confined to the Exchange transactions of the Market-Makers for which it is established. No Exchange transactions of the Clearing Member or proprietary Market-Makers shall be included in a combined Market-Makers' account that is used for the Exchange transactions of Market-Makers that are not proprietary Market-Makers. Likewise, no Exchange transactions of associated Market-Makers shall be included in a combined Market-Makers' account that is used for the Exchange transactions of Market-Makers that are not associated Market-Makers. The Clearing Member agrees, and represents to the Corporation that it has obtained the agreement of each Market-Maker on whose behalf positions may be maintained in a combined Market-Maker[']s' account, that (i) the positions of such Market-Maker may be commingled in a combined Market-Makers' account with the positions of the Clearing Member acting as Market-Maker or of other proprietary Market-Makers if such Market-Maker is a proprietary Market-Maker; with the positions of other associated Market-Makers if such Market-Maker is an associated Market Maker, or with other Market-Makers that are not proprietary or associated Market-Makers if such Market-Maker is not a proprietary or associated Market-Maker; (ii) the Corporation shall have a restricted lien on all long positions in securities options[,] and on other securities (including security futures) [, margin and other funds] in such combined Market-Makers' account and the proceeds thereof and a general lien on all other funds and property in such combined Market-Makers' account [with the Clearing Member as security for the Clearing Member's obligations to the Corporation in respect of all Exchange transactions effected through such account, short positions maintained in such account, and exercise notices assigned to such account], (iii) the Corporation shall have the right to net all writing transactions against all purchase transactions effected in such account in accordance with the Rules, (iv) the Corporation may close out the positions in the account, and apply the proceeds thereof, at any time without prior notice to the Clearing Member or Market-Maker, and (v) notwithstanding the provisions of clause (i) hereof, if a combined Market-Makers' account is confined to the Exchange transactions of [the Market-Maker is] the Clearing Member [or a] and proprietary Market-

Makers, the [Corporation's] Corporation shall have a general lien on all [long] positions and on all other securities, margin, and other funds and property in such account, [shall be security for all of the Clearing Member's obligations to the Corporation] and the account shall be a "firm lien account."

(d) [no change]

(e) Every Clearing Member [Organization] conducting a public business in which it effects Exchange transactions for securities customers shall also establish and maintain a customers' account, which shall be confined to the Exchange transactions of such Clearing Member [Organization]'s securities customers. The Clearing Member, on behalf of itself and each securities customer on whose behalf positions may be maintained in the customers' account, agrees that the Corporation shall have a restricted lien [to the extent set forth in the By-Laws and Rules] on all unsegregated long positions in securities options and on all other securities (other than segregated long positions) [(including security futures) in such account and the proceeds thereof, and on all [margin and] other funds and property in such account (other than segregated long positions) [as security for the Clearing Member's obligations to the Corporation in respect of all Exchange transactions effected through such account, short positions maintained in such account, and exercise notices assigned to such account].

(f) Every Clearing Member [Organization] conducting a public business in which it effects Exchange transactions for futures customers shall also establish and maintain a segregated futures account, which shall be confined to the Exchange transactions in futures and futures options of such Clearing Member [Organization]'s futures customers. Notwithstanding the preceding sentence, [if each of the] in the case of those futures customers for which a Clearing Member [Organization] effects transactions [is a] that are futures professionals, the Clearing Member [Organization] is not required to maintain a segregated futures account under this paragraph (f), but instead may maintain a segregated futures professional account, as provided in paragraph (j)[,] below. The Clearing Member, on behalf of itself and each futures customer on whose behalf positions may be maintained in the segregated futures account, agrees that the Corporation shall have a restricted lien on all positions, margin and other funds and property in such account as security for the Clearing Member's obligations to the Corporation for the positions in that account and in any segregated futures professional account maintained by the Clearing Member pursuant to paragraph (j) below. The Corporation shall comply with applicable regulations of the Commodity Futures Trading Commission pertaining to the holding of segregated funds by clearing organizations of contract markets.

(g) [no change]

(h) A JBO Participants' account, which shall be confined to the Exchange transactions of the JBO Participants for which it is established. The Clearing Member agrees, and represents to the Corporation that it has obtained the agreement of each JBO Participant on whose behalf positions may be maintained in the JBO Participants' account, that (i) the positions of such JBO Participant may be commingled with the positions of other JBO Participants, (ii) the Corporation

shall have a restricted lien on all long positions [,] in securities options and on all other securities (including security futures), [margin and] in such JBO Participants' account and a general lien on all other funds and property in such JBO Participants' account with the Clearing Member [as security for the Clearing Member's obligations to the Corporation in respect of all Exchange transactions effected through such account, short positions maintained in such account, and exercise notices assigned to such account,] (iii) the Corporation shall have the right to net all writing transactions against all purchase transactions effected in such accounts in accordance with the Rules, and (iv) the Corporation may close out positions in the account, and apply the proceeds thereof, at any time without prior notice to the Clearing Member or JBO Participant. Except for purposes of Chapter IV of the Rules, or where the context requires otherwise, all provisions in the By-Laws and the Rules which apply to Market-Makers or a Market-Maker['s] account with the Corporation shall be deemed to apply with equal force to JBO Participants and to a JBO Participants' account with the Corporation, and all references in the By-Laws and the Rules to Market-Makers shall be deemed to also refer to JBO Participants.

(i) A customers' lien account for those securities customers that are eligible, and that have elected, to carry accounts with the Clearing Member that are margined on a portfolio risk basis or pursuant to a cross-margining arrangement, in accordance with Exchange Rules. The Clearing Member, on behalf of itself and each customer on whose behalf positions may be maintained in the customers' lien account, agrees that (i) the positions of such customer may be commingled with the positions of other eligible customers, (ii) the Corporation shall have a restricted lien on all long positions [,] in securities options and on all other securities (including security futures) [,] in such account, and on [margin and] all other funds and property in such account [as security for all of the Clearing Member's obligations to the Corporation in respect of such account], and (iii) the Corporation may close out positions in such account and apply the proceeds thereof at any time without prior notice to the Clearing Member or customer. A separate customers' lien account may be established in connection with a cross-margining program for eligible customers between the Corporation and one or more Participating CCOs, and any such account shall be subject to such additional provisions and security interests as may be set forth in the By-Laws and Rules and in the applicable Participating CCO Agreement.

(j) A segregated futures professional account, which shall be confined to the Exchange transactions in futures and futures options of the Clearing Member's futures customers who are futures professionals. The Clearing Member, on behalf of itself and each futures professional on whose behalf positions may be maintained in the segregated futures professional account, agrees that the Corporation shall have a restricted lien on all positions, margin and other funds in such account as security for the Clearing Member's obligations to the Corporation arising from that account and any segregated futures account maintained by the Clearing Member pursuant to paragraph (f) above and that the Corporation may close out the positions in the account and apply the proceeds thereof at any time without prior notice to the Clearing Member or any futures professional. The Corporation shall comply with applicable regulations of the Commodity Futures Trading Commission pertaining to the holding of segregated funds by clearing organizations of contract markets.

(k) A proprietary futures professional account, which shall be confined to the Exchange transactions of futures professionals whose transactions are not required to be treated as the transactions of securities customers or of futures customers. The Clearing Member, on behalf of itself and each other futures professional on whose behalf positions may be maintained in the proprietary futures professional account, agrees that the Corporation shall have a general lien on all positions and on all other securities, margin and other funds in such account [as security for all of the Clearing Member's obligations to the Corporation], and the Corporation may close out the positions in the account and apply the proceeds thereof at any time without prior notice to the Clearing Member or any futures professional. Such account shall be a "firm lien account."

... Interpretations and Policies:

.01 [no change]

.02 The fact that a Clearing Member may have accounts under more than one Clearing Member number shall have no significance for purposes of a liquidation of a Clearing Member's accounts under Chapter XI of the Rules, and all such accounts—whether or not representing separate business segments or divisions—shall be treated as accounts of the same suspended Clearing Member. Although a Clearing Member may maintain more than one firm lien account with the Corporation, all of the Clearing Member's firm lien accounts established under paragraphs (a), (b)(iv), (c)(v), and (k) of this Section 3 shall be treated as a single firm lien account in the event of such a liquidation. Similarly, in such an event, all of the Clearing Member's firm non-lien accounts established under paragraph (a) of this Section 3 shall be treated as a single firm non-lien account, all of the Clearing Member's combined Market-Makers' accounts established under paragraph (c) of this Section 3 for associated Market-Makers will be treated as a single combined Market-Makers' Account, all of the Clearing Member's combined Market-Makers' accounts established under paragraph (c) of this Section 3 for Market-Makers that are not proprietary or associated Market-Makers will be treated as a single combined Market-Makers' Account, all of the Clearing Member's customers' accounts established under paragraph (e) of this Section 3 shall be treated as a single customers' account, all of the Clearing Member's segregated futures accounts established under paragraphs (f) and (j) of this Section 3 shall be treated as a single segregated futures account, all of the Clearing Member's JBO Participants' accounts established under paragraph (e) of this Section 3 shall be treated as a single JBO Participants' account, and all of the Clearing Member's customers' lien accounts established under paragraph (i) of this Section 3 shall be treated as a single customers' lien account. Each separate account maintained by a Clearing Member under paragraph (b) or (d) of this Section 3, with the exception of a proprietary Market-Maker account, shall be treated in a liquidation as a separate account. Whenever a group of restricted lien accounts is treated as a single account in accordance with this Interpretation .02, all assets subject to the restricted lien shall secure obligations arising in any of the accounts within such group of accounts.

.03 - .04 [no change]

.05 As used in this Section 3[,]; (i) the phrase “all long positions, securities, margin and other funds” is deemed to include any “investment property” as that term is defined in Article 9 of the Uniform Commercial Code (including long and short positions in security futures) and any other asset in the applicable account;[. Additionally, as used in this Section 3,]; (ii) the phrase “obligations to the Corporation in respect of all Exchange transactions” includes any and all obligations arising directly or indirectly from an Exchange transaction, including, without limitation, (a) obligations relating to any long or short position in any cleared contract that is created in an Exchange transaction, (b) any obligation to make a cash payment, or physical delivery of an underlying interest, resulting from the exercise of, assignment of an exercise notice to, or maturity of such a cleared contract, and (c) any fees or charges imposed by the Corporation with respect to such Exchange transactions; and (iii) references to securities or other property “in” an account includes any securities or other property that are identified as deposited as margin in respect of such account.

* * *

RULES

Chapter I

Definitions

RULE 101 – Definitions

A.—Q. [no change]

R.

Restricted Letter of Credit

(1) The term “restricted letter of credit” shall mean, in relation to a restricted lien account, a letter of credit deposited with the Corporation pursuant to Rule 604(c), or portion of the [principal] amount of such a letter of credit, which does not constitute margin for any account or accounts maintained by the depositing Clearing Member other than [its customer’s] the account or accounts specified in the letter of credit.

S.—Z. [no change]

* * *

Chapter VI

Margin

* * *

Segregation of Long Option Positions

RULE 611. (a) [no change]

(b) Each business day, during such hours as the Corporation may from time to time establish, a Clearing Member may file with the Corporation written instructions, in such form as the Corporation may from time to time prescribe, designating any segregated long position in such Clearing Member's customers' account or firm non-lien account which the Clearing Member desires the Corporation to release from segregation. The Clearing Member's Daily Position Report and Daily Margin Report for the following business day, and each business day thereafter while such instructions remain in effect, shall reflect such instructions. The Corporation shall have a lien on each unsegregated long option carried in a customers' account or a firm non-lien account (including any exercised option contracts) as provided in the applicable provisions of Article VI, Section 3 of the By-Laws. [security for the obligations of the Clearing Member to the Corporation in respect of all Exchange transactions effected through such account, short positions maintained in such account, exercise notices assigned to such account, and dividend equivalents payable in respect of such account, and on each unsegregated long option carried in a firm non-lien account (including any exercised option contracts) as security for all of the Clearing Member's obligations to the Corporation other than obligations to the Corporation in the firm account of such Clearing Member.] The Corporation's lien on any long position which the Corporation has been directed to release from segregation as provided herein shall continue until (i) the Corporation receives instructions, in such form as the Corporation may from time to time prescribe, directing that such long position be segregated and held free of lien, and (ii) the Clearing Member duly pays to the Corporation in accordance with these Rules, all amounts payable by such Clearing Member on the business day following the Corporation's receipt of such instructions.

(c) [no change]

* * *

Chapter XI

Suspension of a Clearing Member

* * *

Creation of Liquidating Settlement Accounts.

RULE 1104. (a) Upon the suspension of a Clearing Member, the Corporation shall promptly convert to cash, in the most orderly manner practicable, all margins deposited with the Corporation by such Clearing Member in all accounts (excluding securities held in a specific deposit or escrow deposit) and all of such Clearing Member's contributions to the Clearing Fund; provided, however, that (i) cash derived from margin[s] deposited in respect of segregated futures accounts (including any segregated futures professional account) shall not be commingled with any other cash, and may be applied only to the obligations of such segregated futures accounts, and [provided, further, that] (ii) if the issuer of a letter of credit deposited by such Clearing Member pursuant to Rule 604(c) shall agree in writing to extend the irrevocability of its commitment thereunder in a manner satisfactory to the Corporation, the Corporation may, in lieu of demanding immediate payment of the face amount of such letter of credit, but reserving its right thereto, demand only such amounts as it may from time to time deem necessary to meet anticipated disbursements from the Liquidating Settlement Accounts provided for below. These and all other funds of the suspended Clearing Member subject to the control of the Corporation, except proceeds of segregated long positions, funds disposed of pursuant to Rules 1105 through 1107, and funds held in or payable to a segregated futures account, shall be placed by the Corporation in a special account, to be known as the Liquidating Settlement Account, in the name of the suspended Clearing Member, for the purposes hereinafter specified. Funds held in or payable to segregated futures accounts, and only such funds, shall be placed by the Corporation in a separate special account, to be known as the Segregated Liquidating Settlement Account, in the name of the suspended Clearing Member, for the purposes herein specified. Funds obtained from the issuer of a letter of credit shall be disbursed only after all other funds contained in the Liquidating Settlement Account, with the exception of funds derived from the suspended Clearing Member's contributions to the Clearing Fund, have been exhausted, or in the case of a letter of credit indicating on its face that it is being deposited to serve as margin for a segregated futures account, only after all other funds contained in the Segregated Futures Liquidating Settlement Account, have been exhausted. In the event the sum of (i) the proceeds from any restricted letter of credit held in [the customers'] a restricted lien account, (ii) the proceeds from the closing out of positions and securities in a restricted lien account over which the Corporation has a restricted lien as provided in Article VI, Section 3 of the By-Laws, [unsegregated long positions in options and BOUNDS and any variation payments received from closing out long or short positions in futures in the customers' account, and] (iii) the proceeds from the closing out of exercised option contracts, matured futures and expired BOUNDS in [the

customers'] such restricted lien account, and (iv) the proceeds from the liquidation of securities held as margin in such restricted lien account should exceed the amount withdrawn by the Corporation from the Liquidating Settlement Account pursuant to Rules 1105 through 1107 in respect of transactions or positions in [the customers'] such restricted lien account, the excess shall be remitted by the Corporation to the suspended Clearing Member or its representative for distribution to the persons entitled thereto in accordance with applicable law. In the event the sum of (i) the proceeds from any restricted letter of credit held in segregated futures accounts, (ii) any variation payments received from closing out long or short positions in futures in segregated futures accounts, and (iii) the proceeds from the closing out of matured futures and long futures options positions in segregated futures accounts should exceed the amount withdrawn by the Corporation from the Segregated Liquidating Settlement Account pursuant to Rules 1105 through 1107 in respect of transactions or positions in all segregated futures accounts, the excess shall be remitted by the Corporation to the suspended Clearing Member or its representative for distribution to the persons entitled thereto in accordance with applicable law. Notwithstanding the foregoing provisions of this rule, margin and all other funds of a suspended Clearing Member in respect of sets of X-M accounts (other than such Clearing Member's contributions to the Clearing Fund) shall be subject to Rule 707 and the applicable Participating CCO Agreement and not to this Rule.

(b)-(c) [no change]

(d) After all of a suspended Clearing Member's obligations to the Corporation have been satisfied and the Corporation has made or provided for the remittances described in Rule 1104(a) in respect of the Clearing Member, if the Clearing Member is a Common Member and a positive balance remains in the Liquidating Settlement Account of the Clearing Member (taking into account the remaining value, if any, of any letter of credit the irrevocability of which has been extended in accordance with the provisions of rule 1104(a)), the Corporation may pay any or all of such balance to one or more Cross-Guaranty Parties in accordance with the provisions of their respective Limited Cross-Guaranty Agreements.

Item 2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by OCC's Board of Directors at a meeting held on September 28, 2004.

Questions regarding the proposed rule change should be addressed to Jean M. Cawley, First Vice President and Deputy General Counsel, at (312) 322-6269.

Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The proposed rule change has two complementary purposes: (1) to eliminate certain unnecessary restrictions on the use of margin in the liquidation of a suspended Clearing Member under Chapter XI of the Rules, and (2) to ensure that other restrictions on the use of margin that are appropriately imposed in the By-Laws are properly reflected in Chapter XI of the Rules.

Introduction

Provisions in OCC's By-Laws relating to the potential use of securities and other margin assets in the event of a Clearing Member's liquidation restrict the use of such assets in ways not required under applicable laws and regulations. In addition, certain provisions of OCC's Rules applicable to Clearing Member liquidations do not fully or clearly reflect limitations imposed by the By-Laws.

OCC wishes to amend Chapter XI of the Rules to more precisely reflect appropriate limitations on the use of Clearing Member margin deposits, and to amend provisions of the By-Laws to allow OCC to make use of those margin deposits to the fullest extent consistent with (i) applicable customer protection provisions and (ii) the ability of OCC and Clearing Member systems to identify margin assets subject to those provisions.

Background

Article VI, Section 3 of the By-Laws sets out a number of different types of accounts that a Clearing Member may establish and maintain on OCC's books including a firm account, separate Market-Maker's accounts, combined Market-Makers' account, customers' account, and

others. For each of these account types, Section 3 provides that OCC shall have a lien on property in the account and specifies the extent of the obligations secured by the lien. For example, in the case of the firm lien account, Section 3(a) of Article VI states that “the Corporation shall have a lien on all positions and on all other securities, margin and other funds in such account *as security for all of the Clearing Member’s obligations to the Corporation*” [emphasis added]. This language permits all of the Clearing Member’s assets on deposit with OCC in respect of the firm account to be applied to any obligation of the Clearing Member to OCC, regardless of whether that obligation arises from the firm account, a Market Maker’s or customers’ account or otherwise. This is appropriate in that, generally speaking, the Clearing Member may deposit in respect of the firm account only those assets that it is permitted under applicable law to treat as its own. Such assets include all cash not required by Commission Rule 15c3-3 to be deposited in a special reserve bank account for the benefit of customers as well as any securities that belong to the Clearing Member and not to its “customers” as defined in the Commission’s “hypothecation rules” (Rules 15c2-1 and 8c-1).

The lien language applicable to assets in other types of accounts, however, restricts the application of margin assets to obligations of the Clearing Member arising from that particular account. For example, in the case of a combined Market-Makers’ account (other than a “proprietary” combined Market-Makers’ account), Section 3(c) of Article VI states that “the Corporation shall have a lien on all long positions, securities, margin and other funds in such combined Market-Maker’s account with the Clearing Member as security for the Clearing Member’s obligations to the Corporation in respect of all Exchange transactions effected through such account, short positions maintained in such account, and exercise notices assigned to such

account.” Under this language, OCC’s lien on margin assets deposited in respect of a combined Market-Makers’ account does not secure any obligations of the Clearing Member other than those arising from this account.¹

These limitations on the use of assets in an account to obligations arising from the same account were adopted in order to avoid violation by Clearing Members of the hypothecation rules cited above.² Those rules, which are substantially identical to one another, provide in pertinent part that a broker or dealer may not permit securities carried for the account of any “customer” to be commingled with securities “carried for any person other than a bona fide customer under a lien for a loan made to such broker or dealer.”³ Although it is not at all clear that this language should apply to OCC’s lien, which is not a “lien for a loan” in the ordinary sense, OCC has historically taken the conservative view that it does apply and does not propose now to do otherwise.

Nevertheless, it is clear that the hypothecation rules apply only to “*securities* carried for the account of any customer [emphasis added].” Assets other than securities are not subject to the rule. Thus, a Clearing Member is not required to segregate cash received by a Clearing

¹ In some cases, however, multiple accounts of the same account type are treated as a single account as provided in Interpretation .02 following Article VI, Section 3 of the By-Laws. Thus, for example, if a Clearing Member maintains more than one Combined Market Makers' Account for "associated market makers," those accounts would be treated as a single account for liquidation purposes. Similarly, multiple securities customers' accounts would be treated as a single securities customers' account for liquidation purposes.

² The rule is actually more restrictive than would be required under the hypothecation rules because OCC could lawfully apply assets in the account to obligations arising from the customers' account and any other accounts in which positions of securities “customers” as defined in the hypothecation rules) are carried. Similarly, assets in the public customers' account could be applied to obligations arising from a Market-Maker account. As a matter of policy, however, OCC has maintained the separation continued here.

³ Rule 15c2-1(a)(2) and Rule 8c-1(a)(2). The term “customer” is defined in paragraph (b)(1) of these rules not to include partners, officers or directors of the broker-dealer, or a participant in a joint account with a broker-dealer. Unlike Rule 15c3-3, however, the hypothecation rules do not exclude broker-dealers from the definition of “customer.” Accordingly, Market-Makers who do not have any of these specified relationships with their clearing broker must be treated as “customers” for purposes of the hypothecation rules.

Member from any securities customer from other cash deposited by the Clearing Member with OCC as margin. Subject to the requirement to fund its special reserve bank account under Rule 15c3-3(e) (and any "PAIB" account that the broker-dealer has agreed to maintain), a broker-dealer may treat cash received from securities customers as its own. A Clearing Member is therefore permitted to deposit cash (other than cash received from commodity customers, which is required to be segregated under provisions of the Commodity Exchange Act (the "CEA")) as margin for any of its accounts at OCC without regard to the source of the cash. Accordingly, the lien language applicable to combined Market-Makers' accounts and certain other account types is overly restrictive as applied to cash and any other non-securities assets that might be deposited as margin in the account.⁴ OCC's lien could lawfully be applied to such non-securities assets to secure any obligation of the Clearing Member to the same extent as if the cash had been deposited in respect of the Clearing Member's firm lien account.

It is also true that, when securities other than customer securities are deposited with OCC as margin in respect of a customer account (other than a commodity customer account, segregated pursuant to provisions of the CEA), those securities would not for that reason alone have to be treated as "securities carried for the account of any customer," and OCC's lien could lawfully apply. However, there are no systems in place that allow OCC to distinguish between customer and non-customer securities when they are deposited in respect of a customer account (including a Market-Maker account). Accordingly, OCC will continue to treat all securities

⁴ At present, the only other non-securities assets that may be deposited as margin are letters of credit ("LOCs"). LOCs are subject to special rules in that an LOC may be secured by customer securities pledged by the broker-dealer to the issuer of the LOC, in which case the LOC would be subject to the restrictions applicable to the securities. The broker-dealer may comply with those restrictions under OCC's Rules by designating the LOC as a "restricted" LOC and specifying which account type is secured by the LOC.

deposited as margin in respect of any securities account other than a proprietary account as if they were customer securities for purposes of the hypothecation rules.

Proposed Changes in Article I and Article VI, Section 3 of the By-Laws

In order to address the discrepancies described above, OCC is proposing to amend Article I, Section 1 of the By-Laws to define two different types of liens: a “general lien” and a “restricted lien.” Assets subject to a “general lien” serve as security for *all* obligations of the Clearing Member to OCC, regardless of the origin or nature of those obligations. The proposed rule change would also define a “general lien account” as one in which OCC has a general lien over *all* assets in the account. Thus, the firm account and any other proprietary account, such as a proprietary Market-Maker’s account, would be a general lien account, and all such accounts would be treated as a single firm lien account in a liquidation of the Clearing Member. This is precisely the same result as under the present rules.

The definition of a “restricted lien” provides that assets in an account that are specified as subject to such a lien serve as security only for obligations arising in that particular account or a specified group of accounts to which that account belongs.⁵ A “restricted lien account” is defined as an account in which *specified* assets are subject to a restricted lien. All accounts other than the various types of proprietary accounts are “restricted lien accounts.” However, not all assets in those accounts are subject to a restricted lien. Cash and any other non-securities assets in a restricted lien account, because they are not subject to the restrictions of the hypothecation rules, would be subject to a “general lien.” An exception is made, however, for

⁵ The reference to groups of accounts is necessary because, for example, a Clearing Member may have multiple Combined Market Makers’ accounts that would be liquidated as if they were a single account. The same would be true if a Clearing Member had more than one securities customers’ account. These account groupings are addressed in existing Interpretation .02 following Article VI, Section 3 of the By-Laws.

the securities customers' account and the customer lien account, where all assets, including cash, would be subject only to a restricted lien. The reason for this exception is that, although these non-securities assets are not subject to the hypothecation rules, the provisions of Rule 15c3-3(e) and in particular the reserve formula used in calculating the amount of funds a Clearing Member is required to deposit in the special reserve bank account for the exclusive benefit of customers is provides a "debit" (i.e., a reduction in the required deposit) reflecting "[m]argin required and on deposit with [OCC] for all option contracts written or purchased in customer accounts." Given this debit in the reserve formula, it would appear to be inconsistent to use funds in the account as collateral for obligations other than those arising in such accounts, and this limitation is reflected in the proposed rule change.

In order to eliminate unnecessary restrictions on the use of non-securities assets in certain accounts as described above, OCC proposes to modify the lien language appearing in the following paragraphs of Article VI, Section 3: paragraph (a), to the extent applicable to firm non-lien accounts; paragraph (b) to the extent applicable to separate Market-Maker accounts other than proprietary Market-Maker accounts; paragraph (c), to the extent applicable to combined Market-Makers' accounts other than proprietary combined Market-Makers' accounts; and (h) applicable to "JBO Participants' accounts." The modification necessary in each case is to provide that margin assets deposited in respect of the applicable account and consisting of cash and other non-securities collateral may be applied to any obligation of the Clearing Member rather than only to obligations arising from that account. This is accomplished by subjecting securities assets in the accounts to a "restricted lien" while non-securities assets in certain of the account are subject to a "general lien." Other changes in Article VI, Section 3 are non-

substantive housekeeping changes intended to make use of the newly defined terms, improve consistency, eliminate repetition, clarify ambiguities, etc.⁶

In order to conform to the changes made in provisions of Article VI, Section 3(a) relating to firm non-lien accounts and in Section 3(e) relating to the securities customers' account, OCC is proposing to delete the specific lien language applicable to unsegregated long positions as set forth in Rule 611. The extent of these liens would now be set forth in the cited provisions of Article VI, Section 3.

Proposed Changes in Rule 1104 and Related Changes

Notwithstanding the limitations of the existing lien language described above applicable to accounts other than proprietary accounts, these limitations are not fully reflected in the provisions of OCC's Rule 1104(a), which governs the creation of a "liquidating settlement account" and payments from that account in a Clearing Member liquidation. Rule 1104(a) presently provides, in effect, that proceeds from a "restricted letter of credit" (i.e., a letter of credit secured by customer securities—see note 4 above)⁷, unsegregated long positions, and variation payments resulting from positions in security futures in a public customers' account, may not be applied to obligations other than those arising from the public customers' account. It does not similarly restrict the use of proceeds of securities deposited directly as margin for that account even though the application of such securities to obligations arising out of other accounts would arguably be in violation of the hypothecation rules and even though such use would be

⁶ No changes of substance are proposed to be made with respect to futures accounts subject to segregation requirements under the CEA.

⁷ The definition of "restricted letter of credit" in Rule 101 is proposed to be amended in order to make it more generic. In current practice, restricted letters of credit are used not only for the securities customers' account, but may also be used in a segregated futures account. The letter of credit must indicate on its face the purpose or purposes to which it may be applied.

inconsistent with OCC's restricted lien on those securities. In the event of a Clearing Member liquidation prior to the approval of this rule change, OCC would observe the limitations of the hypothecation rules and the lien language as it presently exists in OCC's By-Laws notwithstanding that those limitations are not fully reflected in Rule 1104(a). Those limitations are fully consistent with OCC's risk management system in that OCC has never set margin or clearing fund requirements with the expectation that it would have excess collateral in one account that could be applied against obligations arising in other accounts. OCC determines its risk margin requirements on each Clearing Member account independently.

Nevertheless, if there were a shortfall in liquidating any Clearing Member account, it would obviously be in the interest of OCC, its Clearing Members and the integrity of the clearing system if OCC were able to apply the margin assets that it holds to the fullest extent practicable without violating applicable law. In addition, the intended restrictions on the use of proceeds of positions and securities in the securities customers' account as well as in Market Maker accounts and other restricted lien accounts (as we are now proposing to refer to them generically) should be clearly stated. By making use of the newly defined terms "general lien" and "restricted lien" and by relying on the provisions of Article VI, Section 3 as proposed to be amended, only relatively minor amendments to the provisions of Rule 1104(a) are required to effectuate the dual purposes of this proposed rule change. Other proposed changes in Rule 1104 are intended for clarification only and are not substantive.

* * *

The proposed rule change is consistent with the purposes and requirements of Section 17A of the Securities Exchange Act of 1934 (the "Exchange Act") because it will promote the

prompt and accurate clearance and settlement of securities transactions, remove impediments to the mechanisms of a national system for the prompt and accurate clearance and settlement of securities transactions and assure the safeguarding of securities and funds in the custody or control of OCC by clarifying limitations on the use of certain customer property in the event of a clearing member insolvency while protecting the clearing system by permitting broader use of other collateral deposited by Clearing Members.

Item 4. Self-Regulatory Organization's Statement on Burden on Competition

OCC does not believe that the proposed rule change would impose any material impact on competition.

Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others.

Written comments were not and are not intended to be solicited with respect to the proposed rule change, and none has been received.

Item 6. Extension of Time Period for Commission Action

OCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Neither is sought.

Item 8. Proposed Rule Change Based on Rules of Another Regulatory Organization or of the Commission

The proposed rule change is not based on a rule change of another self-regulatory organization.

Item 9. Exhibits

Exhibit 1 Completed notice of the proposed rule change for publication in the Federal Register.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

THE OPTIONS CLEARING CORPORATION

By: William H. Navin
William H. Navin
Executive Vice President
and General Counsel